Michigan Department of Labor and Economic Growth

Agency Report to the

JOINT COMMITTEE ON ADMINISTRATIVE RULES

Rev. 2002

Rule:	R 500.2151 – R 500.2155 (proposed)
Agency: DLEG – Office of Financial & Insurance Services	

1. Name, address, FAX and phone numbers of agency contact person:

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2. Purpose for the proposed rules and background:

Over the past five or more years, insurers in Michigan have gradually implemented a rating system for private passenger automobile, home, and other personal lines of insurance that classifies or rates consumers in part by use of information contained in the consumer's credit report. Through data calls, filings, public hearings, consumer complaints, and research on this subject, the Office of Financial and Insurance Services (OFIS) has gathered information that establishes that Michigan insurers have increased their base rates over the same period of time in part to provide a discount or tiers of discounts for consumers with particular insurance credit scores or a particular score within a range of insurance credit scores. Insurers arrive at insurance credit scores by applying to the consumer's credit report or credit information a model or formula either developed in house or purchased from Fair Isaac, ChoicePoint, or another vendor. Insurers usually secure the consumer's credit report from one of the three major consumer reporting agencies - TransUnion, Experion, or Equifax – though insurers may also consult other, smaller consumer reporting agencies for information. Each insurance company factors credit information into its classification system and may use different credit factors or attach different weights to different credit factors when rating for automobile, home, or other personal lines policies. To arrive at the premium charged an individual consumer, generally insurers use a "good" credit score to grant a larger percentage "discount" from the base rate, while a "poor" credit score results in a much smaller discount or no discount at all from the base rate.

The consumer typically receives a premium notice or quote stating that credit information has been used in arriving at the premium and referring the consumer to a toll-free telephone number for the consumer reporting agency that supplied the credit report. A consumer questioning the premium charged must secure his or her credit report, check it for accuracy, dispute any inaccuracies, and upon getting an error corrected, then request the insurer to refigure the premium charged, all without access to the particular scoring model used by the insurer. Consumers with poor credit and consumers without current credit records – often the young and the old but also many other people who for one reason or another do not choose to borrow money at all or do not borrow from lenders who report to credit reporting agencies – find themselves charged more for automobile, home, or other personal lines of insurance because they do not qualify for any "good credit" discount. Additionally, in selling group coverage, some insurers impose a surcharge on persons with low insurance credit scores.

The purposes of Essential Insurance are identified in the title to the Insurance Code of 1956, 1956 PA 218, MCL 500.100 et seq. (Insurance Code), as follows:

> . . to provide for the continued availability and affordability of automobile insurance and home insurance in this state and to facilitate the purchase of that insurance by all residents of the state at fair and reasonable rates.

Insurance Credit Scoring is being used in rates filed under the Essential Insurance Act, Chapter 21 of the Insurance Code, MCL 500.2101 to 500.2131 (applicable to individual automobile and home insurance); Chapter 24 of the Insurance Code for casualty policies, MCL 500.2400 to 500.2484 (applicable to group automobile and home insurance and other personal lines covering mobile homes, rental properties, recreational vehicles, motorcycles, and boats); and Chapter 26 of the Insurance Code for property policies, MCL 500.2600 to 500.2674 (applicable to group home insurance and the other personal lines also subject to Chapter 24). Since Michigan is a "file and use" state, insurers file their classifications and rates and begin to use them, without prior approval from the Commissioner. MCL 500.2106, MCL 500.2430, MCL 500.2628.

MCL 500.2109 requires that rates for automobile and home insurance "shall not be excessive, inadequate, or unfairly discriminatory;" and MCL 500.2109(1)(c) provides:

> A rate for a coverage is unfairly discriminatory in relation to another rate for the same coverage if the differential between the rates is not reasonably justified by differences in losses, expenses, or both, or by difference in the uncertainty of loss, for the individuals or risks to which the rates apply. A reasonable justification shall be supported by a reasonable classification system; by sound actuarial principles when applicable; and by actual and credible loss and expense statistics or, in the case of new coverages and classifications, by reasonably anticipated loss and expense experience.

The same standard for "unfairly discriminatory" appears verbatim in Chapter 24, MCL 500.2403(1)(d), and in Chapter 26, MCL 500.2603(1)(d), for group automobile, group home, and other personal lines subject to those chapters. A "reasonable classification system" is defined by administrative rule R 500.1505(3) as:

> A system designed to group individuals or risks with similar characteristics into rating classifications which are likely to identify significant differences in mean anticipated losses or expenses, or both, between the groups, as determined by sound actuarial principles and by actual and credible loss and expense statistics or, in the case of new coverages or classifications, by reasonably anticipated loss and expense experience.

Except for those companies exempt under MCL 500.2129, Michigan does not allow the use of insurance credit scoring to refuse to write an individual or group automobile or home policy, cancel a policy, or non-renew a policy. MCL 500.2117 (home), MCL 500.2118 (automobile), MCL 500.2105 (group.)

MCL 500.2111 provides an exclusive list of the classifications or rating factors an automobile insurer and a home insurer may use, with the proviso in subsection (9) that an insurer may use additional factors only if the Commissioner finds, **after** an Administrative Procedures Act contested case hearing that the factors "would encourage innovation, would encourage insureds to minimize the risk of loss from hazards insured against, and would be consistent with the purposes of this chapter." Insurance credit scoring is not among the factors specified in MCL 500.2111, and no automobile or home insurer has requested of the Commissioner a contested case hearing and an opportunity to prove that insurance credit scoring meets the quoted requirements of subsection (9).

MCL 500.2110a is the only statutory provision possibly justifying or authorizing the use of insurance credit scoring in Michigan. It states:

> If uniformly applied to all its insureds, an insurer may establish and maintain a premium discount plan utilizing factors in addition to those permitted by section 2111 for insurance if the plan is consistent with the purposes of this act and reflects reasonably anticipated reductions in losses or expenses. This section does not affect benefits or obligations required under chapter 31. Nothing in this section authorizes an insurer to offer or prohibits an insurer from offering premium discount plans concerning any of the following:
> (a) Health care services, health care providers, or health care facilities.
> (b) Automobile repair providers.
> (c) Materials used in the repair of an automobile.

Under this section, the premium discount plan must be uniformly applied, be consistent with the purposes of the act, and reflect reasonably anticipated **reductions** in losses or expenses. Insurers typically grant premium discounts for safety equipment such as anti-lock breaks, smoke alarms, or security systems, i.e. items the presence of which might actually reduce losses. Though business and industry arguing for the use of insurance credit scoring invariably assert a correlation between low credit scores and increased frequency of claims and occasionally extrapolate that correlation to another claimed correlation between low credit scores and the increased cost of claims, no insurer and or entity conducting studies of credit scoring for insurers has yet to present any data even suggesting, much less proving, that the use of insurance credit scoring results in a **reduction** in losses.

In fact, OFIS has the statements of at least two insurers (who are on record as being opposed to this rule set) in which they admit that the use of insurance credit scoring does not result in a reduction in losses. Bill Martin, Chief Product Management Expert for the State of Michigan for Farmer's Insurance Group, testified in front of the Senate Banking and Financial Institutions committee on June 24, 2004 in room 100 of the Farnum Building, as follows:

> Because a ban on credit scoring really doesn't do anything to insurance costs, it only changes the way we rate for those costs, we would end up charging everybody in this state an average rate, an average across all scores, with a ban. And that of course would mean that people with better than average insurance scores would see their rates go up and people with worse than average insurance scores would see their rates go down.

Additionally, Amy Shalley of State Farm Insurance Companies testified at the July 28, 2004

Flint Public Hearing on this rule set as follows:

> Insurance use of credit in pricing has been and will continue to be revenue neutral. Insurance scoring does not change the total amount of premium collected by the insurance companies and a ban of its use will not change the total amount either. What the use of insurance scoring does change is the amount of premium paid by each individual consumer.

MCL 500.2108 (individual automobile and home), MCL 500.2406 (casualty - group automobile, group home and other personal lines), and MCL 500.2606 (property - group home and other personal lines) require insurers to file with OFIS:

> Every manual of classification, every manual of rules and rates, every rating plan, and every modification of a manual of classification, manual of rules and rates, or a rating plan which it proposes to use . . .

Thus, credit scoring models or formulas, as part of an insurer's classification system, are also a required part of each and every rate filing for any insurer using credit scoring. All such filings are public documents or open to public inspection under MCL 500.2108(5), MCL 500.2406(1), and MCL 500.2606(3). OFIS is entitled to know exactly how each insurer calculates premium, and no insurer claim of "proprietary information" or "trade secret" for a credit scoring formula will withstand these clear Insurance Code provisions and the Michigan Freedom of Information Act.

In addition, most policyholders in Michigan are entitled to know exactly how their individual premium is calculated. MCL 500.2112 requires at least annual notice to automobile and home policyholders as follows:

> At least annually, in conjunction with a renewal notice, a bill, or other notice of payment due issued to a policyholder in conjunction with automobile and home insurance contracts, an insurer shall send to each policyholder a written notice of all of the following:
> (a) A description of the specific rating classifications by which the rates and premiums for the policy have been determined. The notice shall be of sufficient detail and clarity so that the policyholder can reasonably verify the applicability and accuracy of the rating classifications.
> (b) A general explanation of the extent to which rates or premiums vary among insureds on the basis of the rating classifications used by the insurer.
> (c) Sources and reasonable procedures by which the individual can obtain from the insurer additional information sufficient for the individual to calculate and confirm the accuracy of his or her specific premium.
> (d) Relevant information regarding the rights of an insured, under sections 2113 and 2114, to appeal the application of the insurer's rating plan in determining his or her premium, to obtain documentation from the insurer regarding the determination of the rate, to appeal the application of the insurer's underwriting rules to the person, to request an informal conference with the insurer, and to file with the commissioner a complaint as an aggrieved person.

(e) A description of all of the insurer's underwriting rules based upon insurance eligibility points and a description of all of the underwriting rules of the insurer's affiliates based upon insurance eligibility points.

(f) A suggestion that the insured contact his or her agent to determine if he or she is eligible for insurance from an affiliate of the insurer or under a different rating plan of the insurer which would provide to the insured insurance at a more favorable premium.

Holders of policies subject to MCL 500.2458 and MCL 500.2652 (which control group automobile, home and other personal lines) are entitled to review the manner in which the rating system has been applied in connection with the coverages they have purchased. Those sections require insurers to furnish to any insured who believes they are aggrieved by the rates, and who requests and pays reasonable charges, all pertinent information as to their rates.

All of the laws quoted above must be read and considered in light of the decision of the Michigan Supreme Court in Shavers v Attorney General, 402 Mich 554; 267 NW2d 72 (1978), the landmark case upholding the constitutionality of the basic no-fault scheme, while finding the "entire rate structure . . . suspect" and further finding a deprivation of due process in a scheme that then shunted people denied insurance coverage in the ordinary market to the Automobile Placement Facility without any assurance of "fair and equitable rates" in either the ordinary market or the Automobile Placement Facility. In the context of compulsory insurance, the court reasoned that, "In effect, insurance companies are the instruments through which the Legislature carries out a scheme of general welfare," and "there exists 'a sufficiently close nexus between the State and the challenged action of the regulated entity so that the action of the [regulated entity] may fairly be treated as that of the State itself.'" (Citing Jackson v Metropolitan Edison Co, 419 U.S. 345, 351 (401 Mich 597.) The court held, at a minimum, no fault insurance does not satisfy constitutional due process unless:

1. The Legislature and/or the Commissioner of Insurance (pursuant to his present rule-making authority, MCL 500.2484; MSA 24.12484), give substantial meaning to the statutory standards "Rates shall not be excessive, inadequate or unfairly discriminatory". See MCL 500.2403; MSA 24.12403; MCL 500.3340; MSA 24.13340.

2. A filed rate, or a rate determined on administrative or judicial review, provides and sets forth:

a) premiums reasonable to insured and insurer for the specific insurance coverage without regard to factors assertedly warranting differences in premiums among those insured;

b) the factors which properly may be considered by the insurer in differentiating premiums among those insured; and

c) the amount of differential appropriate for each such factor.

3. Such information for each insurer is publicized in such a manner that every person affected can readily ascertain the factors and amounts of differentials applicable to him and calculate the premium the insurer may charge.

4. Every motorist has the opportunity to obtain a prompt and effective administrative review of an insurer's calculation of the factors, differentials and premium applicable to him and a

prompt and effective administrative review of the basis for the refusal or cancellation of insurance.

The provisions of the Insurance Code quoted above, particularly those in the Essential Insurance Act on rating factors, rate filings, and notices to policyholders, are there in part as the Legislature's response to the directives from the Supreme Court designed to compel insurers, acting as "instruments" of the government in selling essential insurance, to guarantee consumers' knowledge of the rating factors applicable to them and the resulting ability to shop for the best coverage at the lowest price. Now, as then, the Commissioner is the person designated to implement and enforce the laws governing insurers. Thus insurance companies, in adopting insurance credit scoring, are not operating in an unregulated marketplace. Rather, they are operating subject to all the laws passed by the Legislature quoted above, as interpreted by the courts; and the Commissioner must act to implement those laws to assure the rights of consumers are protected. It is important to note that the Supreme Court dealt only with due process requirements for compulsory no-fault automobile coverage. The Legislature fashioned the idea of "essential" insurance, automobile AND home coverage, with a rating-factor restrictive but "reasonable classification system" for both lines. They also required extensive policyholder disclosures.

By its very nature, the sale of automobile, home, and other personal lines of insurance does not usually involve an extension of credit by the insurer. Purchasers pay for insurance coverage in advance.

In response to consumer complaints of unfair treatment and insurance industry claims of a correlation between insurance credit scores and propensity for loss, former OFIS Commissioner Frank M. Fitzgerald began studying insurance credit scoring more than two years ago, conducted public hearings on the subject, gathered information, and issued a 30+ page report on the topic in December 2002. Although Commissioner Fitzgerald believed insurance credit scoring could be used as a premium discount under MCL 500.2110a, his report also clearly concluded that then-current credit scoring classifications violated the above statutory requirements because filed programs did not include sufficient information to show objective and uniform classifications to justify rate differentials. The report also concluded that insurer filings did not satisfy MCL 500.2110a by identifying reasonably anticipated reductions in losses and expenses and that the insurers' failure to review credit history data at each renewal violated MCL 500.2110a, MCL 500.2109(1)(c), MCL 500.2403(1)(d), and MCL 2603(1)(d). The report likewise found insurers not complying with the required notices to policyholders under MCL 500.2112, MCL 500.2458, and MCL 500.2658, not meeting their responsibilities under MCL 500.2116, and not complying with Fair Credit Reporting Act (FCRA) notices of adverse action (p. 22, December 2002 OFIS report, available at www.michigan.gov/ofis. Once on the OFIS home page, click on "Consumer Services" and then click "Credit Scoring" to access the report).

As a result of the above findings, Commissioner Fitzgerald issued an order and bulletin on February 14, 2003, including the findings contained in the December 2002 report, and directing insurers to take eight specific actions to comply with the above statutes if they chose to continue using insurance credit scoring. Commissioner Linda A. Watters issued another bulletin on May 13, 2003, amending some of the earlier bulletin's directives, but again demanding that insurers file their formulas with OFIS, file their credit classification factors, recalculate scores at the request of the insured, send required policyholder notices, provide actuarial certification, etc.

MCL 500.210 directs the Commissioner to promulgate "rules and regulations in addition to those now specifically provided for by statute as he or she may deem necessary to effectuate the purposes and to execute and enforce the provisions of the insurance law of this state." As consumers continue to complain to OFIS and as insurers continue to use insurance credit scores while failing to comply even with the limited directives in the 2003 OFIS bulletins, Commissioner Watters has concluded that she must act to prevent insurers from avoiding their legal duties to Michigan consumers.

From all the information gathered by both former Commissioner Fitzgerald and current Commissioner Watters in the course of this rule promulgation process, together with all the information submitted in response to data calls or in rate filings with OFIS, there is no longer any doubt that Michigan insurers are not complying with Chapters 21, 24, and 26 of the Insurance Code by using insurance credit scores. There is also no doubt that insurers have, as part of their insurance credit scoring discount plans, raised base rates, a practice that merely selectively apportions premiums among policyholders, without reducing losses, in clear violation of MCL 500.2110a. Commissioner Watters is currently commencing enforcement actions against those insurers who have not complied with the directives in the 2003 bulletins, while also pursuing the promulgation of this rule set applicable to all insurers. The rules process has afforded all interested parties ample opportunity to submit comment and information showing that the use of insurance credit scores is consistent with Michigan law. As discussed in more detail below, the Commissioner has carefully reviewed all of the information and comments and has concluded that this rule set to clarify that insurance credit scoring is not part of the reasonable classification system is necessary to effectuate the purposes and to execute and enforce the statutes cited above.

3. Summary of proposed rules:

The initial draft of the proposed rules banned on or after January 1, 2005 the use of an insurance credit score as a rating factor or underwriting factor for all types of personal insurance, underwritten on a group or individual basis. In response to public comment, the Agency has amended its initial draft to apply to new and renewal policies effective on or after July 1, 2005, to further define "insurance score," and to provide a calculation for the base rate adjustment required. Personal insurance is defined to include private passenger automobile, home, motorcycle, boat, personal watercraft, snowmobile, recreational vehicle, mobile-homeowners, non-commercial dwelling fire insurance policies, and all other policies for personal, family, or household use. The proposed rules also require each insurer using insurance credit scoring to reduce base rates, as of January 1, 2005 in the initial draft, now amended to July 1, 2005, in accordance with the calculation described in amended Rule 4 and to file a certificate with the Commissioner no later than May 1, 2005, attesting that it has made the calculation and reduced base rates accordingly, together with the documentation describing the calculations used in its base rates adjustment.

4. Name and date of publication in newspapers (minimum 3):

June 23, 2004 in each of the following newspapers: Flint Journal, Grand Rapids Press, Detroit News, Detroit Free Press, Lansing State Journal, Marquette Mining Journal

5. Time, date, location and duration of public hearing:

Monday, July 19, 2004, 1-3:20 p.m. Forum, Ground Floor Michigan Library & Historical Center 702 W. Kalamazoo Lansing, Michigan	Wednesday, July 21, 2004 1-3 p.m. Grand Rapids Commission Chambers 300 Monroe Ave. NW Grand Rapids, Michigan
Monday, July 26, 2004, 1-4:30 p.m. Cadillac Place 3044 West Grand Blvd Detroit, Michigan	Wednesday, July 28, 2004, 1-4 p.m. City Hall Council Chambers 1101 South Saginaw Flint, Michigan

6. Date of publication of rules and public hearing notice in *Michigan Register:*

July 1, 2004

7. Agency persons attending hearing (include agency name and title of position):

<u>Department of Labor & Economic Growth, Office of Financial & Insurance Services</u>

Lansing, July 19, 2004 Linda A. Watters, Commissioner Krystal Rourke, Deputy Commissioner, Policy John Schoonmaker, General Counsel Dorothy Cherry, Administrative Law Specialist Marilyn Maloney, Communications Specialist Wendy Nelson, Administrative Assistant Dawn Kobus, Administrative Assistant Christine Nettleton, Departmental Specialist	**Grand Rapids, July 21, 2004** Linda A. Watters Cathy Kirby, Deputy Commissioner, Consumer Services Marilyn Maloney Wendy Nelson Dawn Kobus
Detroit, July 26, 2004 Fran Wallace, Chief Deputy Commissioner Krystal Rourke Dorothy Cherry Wendy Nelson Dawn Kobus Marilyn Maloney	**Flint, July 28, 2004** Linda A. Watters Dorothy Cherry Marilyn Maloney Wendy Nelson Dawn Kobus Krystal Rourke

8. Names, organizations and (complete) addresses of persons attending the hearing:

In Lansing, 83 people attended and 11 spoke. In Grand Rapids, 85 people attended and 11 spoke. In Detroit, 144 people attended and 33 spoke. In Flint, 106 people attended and 23 spoke.

Copies of the sign-in sheets for all four hearings, including the names and addresses of all people attending – 418 people in total – are attached to this report, marked Attachment #1, and are incorporated herein.

9. Persons submitting letters, comments and testimony of support:

Legislators, Governing Bodies, Other Elected Officials

Brenda Clack (oral, Flint)
34th House District
NO798 House Office Bldg.
Lansing, MI 48909-7514

John Gleason (oral, Flint)
48th House District
NO897 House Office Bldg.
Lansing, MI 48909-7514

Elizabeth C. Ayana Johnson (oral, Detroit) for
JoAnn Watson (7-29-04 written comment)
Council Member, Detroit City Council
2 Woodward Ave. Suite 1340
Detroit, MI 48226

Detroit City Council
July 30, 2004 resolution
2 Woodward Ave.
Detroit, MI 48226

Douglas E. Olsen, Mayor
City of Bessemer, UP
XXXX

Academic & Legal

David M. Cannon
Asst. Professor, Accounting
Grand Valley State University
Grand Rapids, MI

Michael R. Sugar, Esq. (oral, Detroit)
26211 Central Park Blvd. # 504
Southfield, MI 48076

Consumers

At the four public hearings, 53 consumers, identified on Attachment #1, spoke in support of the proposed rules. 718 consumers either spoke or submitted written comments supporting the rules. Their names, with residence, appear on a chart marked Attachment #2, incorporated herein. The chart identifies those who complained of inaccurate credit, low credit, catastrophic event affecting credit, thin files, or simply general support for the rule set. Also, two consumers - David Hinds (XXXX) and Hope Lesperance (XXXX) - wrote questioning the proposal for a total ban on insurance credit scoring but supporting regulatory oversight to limit the use of credit scoring to prevent arbitrary action by insurers.

Public Interest Groups, Union, Other

Birny Birnbaum
Center for Economic Justice

Ken Fletcher
Michigan State AFL-CIO

1701A South Second Street
Austin, TX 78704

419 Washington Square South, #200
Lansing, MI 48933-2138

Stuart Heiser
Public Interest Group of Michigan (PIRGIM)
122 South Main Street, #370
Ann Arbor, MI 48104

Lorray S.C. Brown
Michigan Advocacy Project
1115 S. Pennsylvania Ave., #202
Lansing, MI 48912-1658

David Marquardt, Co-Chair
12th Precinct Neighborhood Coalition
College Park, P.O. Box 21733

Patrick Clawson (oral, Flint)
Retired Consumer Affairs reporter
P.O. Box 470
Flint, MI 48501-0470

Jerome O'Bryant (oral, Grand Rapids)
NAACP
19780 M-140
South Haven, MI

Alfred Hawkins (oral, Grand Rapids)
Van Buren Chapter, NAACP
09094 – 76st
South Haven, MI 49090

Lise Thomas (oral, Grand Rapids)
American Debt Counseling
255 28th St. SE
Grand Rapids, MI 49548

H. Bill Maxey (oral, Detroit)
NAACP, Northern Oakland County
28 N. Saginaw
Pontiac, MI

Janice M. Gooley (oral, Flint)
Urban League of Flint
5005 Cloverlawn Dr.
Flint, MI 48504

Jeff Guilfoyle
Economist, MI Dept. of Treasury
XXXX

Tommie Summerville
Metropolitan Christian Council
28 West Adams, Suite 1300
Detroit, MI 48226

Agents

Gary Veenstra (oral, Lansing)
Veenstra Insurance Agency
31700 W 12 Mile
Farmington Hills, MI 48334

Jerry Conner
Conner Insurance Group
26050 Orchard Lake, Suite 200
Farmington Hills, MI 48334

Peter James (oral, Grand Rapids)
Michigan Professional Insurance Agents
4550 Cascade Rd. SE, #2058
Grand Rapids, MI 49546

Will M. Wilson
Camelot Insurance Agency
18052 Pennington Dr.
Detroit, MI 48221-2637

Gil Moorman (oral, Flint) Gil Moorman, Inc. Flint, MI 48502	Jason Grubbs 3821 – 44th St. SW Grandville, MI 49418
National Association of Professional Allstate Agents, Inc.(NAPAA) P.O. Box 170200 St. Louis, MO 63117	United Farmers Agents Assn. (UFAA) Ralph Buchanan, Media Relations RGBUCH@aol.com
Steven J. Grubbs United Insurance Service 311 W. Maple St. Wayland, MI 49348	Phillip Boogaart 1549 Michigan NE Grand Rapids, MI 49503
Gregory F. Gaylor Gaylor Insurance Agency 308 Lake St., Box 735 Roscommon, MI 48653	

10. Persons submitting letters, comments and testimony of opposition:

Legislators

Scott Hummel (oral, Lansing) 93rd House District 1197 Anderson House Office Bldg. Lansing, MI 48909	Fulton J. Sheen (oral, Grand Rapids) 88th House District 1192 Anderson House Office Bldg. Lansing, MI 48909
David Robertson (oral, Flint) 51st House District S0985 House Office Bldg. Lansing, MI 48909-7514	

Business and Industry: Attachment #3, incorporated herein, summarizes the comments submitted by the business and industry representatives identified below:

Jeffrey A. Skelton, Asst. V.P. ChoicePoint 1000 Alderman Drive Alpharetta, GA 30005	Dawn Elzinga & Matt Moran Farm Bureau Ins. Co. of Michigan 7373 W. Saginaw Highway Lansing, MI 48909-7900
Don Heikkinen Michigan Bankers Association 222 N. Washington, Suite 320 Lansing, MI 48933	Eric B. Rosenberg TransUnion LLC 555 West Adams Street Chicago, IL 60661

Charlie P. Neeson
Westfield Group
One Park Circle
Westfield Center, OH 44251

Eric Henning
Michigan Insurance Coalition
Dykema Gossett PLLC
124 W. Allegan, Suite 800
Lansing, MI 48933

David E. Field
Regional Counsel, Allstate Ins. Co.
27555 Executive Drive, Suite 300
Farmington Hills, MI 48331

Michael W. Puerner
Vice Pres., Secretary, & General Counsel
Hastings Mutual Ins. Co.
404 E. Woodlawn Ave.
Hastings, MI 49058

Dyke VanKoevering (oral, Flint) &
Frank M. Fitzgerald
Insurance Institute of Michigan
2455 Woodlake Circle
Okemos, MI 48864-5491

Neil Alldredge
Director, State Affairs
Nat. Assn. of Mutual Ins. Companies
3601 Vincennes Rd.
Indianapolis, IN 46269

Skip Massucci, Director
Pricing & Product Development
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Tom Manning & Amy Shalley
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Farmers Insurance Group
5600 Beech Tree Land
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Judith M. Feldmeier
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Auto Club Insurance Association
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Dearborn, MI 48126-2694

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American Insurance Association
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Insurance Manager
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Wendy Hofmeyer, Director
Health Policy & Human Resources
600 S. Walnut
Lansing, MI 48933-2200

Morrall Claramunt (oral, Flint)
Frankenmuth Mutual
325 Mayer Road
Frankenmuth, MI 48734

Consumer Data Industry Association
1090 Vermont Ave., Suite 200
Washington, D.C. 20005

Academic & Legal:

Professor Stephen Calkins (oral, Detroit)
Wayne State University Law School
Detroit, MI 48202

L. Richard Fischer, Esq.
Morrison & Foerster, LLP
2000 Pennsylvania Avenue, NW
Washington, D.C. 20006-1888

Consumers:

At the four public hearings, only two consumers in Grand Rapids, identified on Attachment #1, spoke in opposition to the rules. Thirty-six consumers, including many insurance company employees, submitted written comments in opposition. Their names and addresses appear on Attachment #4, incorporated herein. These consumers opposed the rules either because they do not want to lose the credit discounts they are receiving or because they work for insurance companies and believe their employers' use of scores is valid.

Agent

Mark Clabeaux
XXXX
XXXX

11. Summary on suggestions to modify proposed rules:

This section is organized by outlining each argument against the proposed rules and responding to that argument, instead of responding to each person or entity opposing the rule set.

Suggestion to modify:

a) The Commissioner should withdraw the proposed rule set because the Legislature is the only appropriate body to deal with the practice of insurance credit scoring. Representative Scott Hummel (93rd District) and Representative Fulton Sheen (88th District) both object to the action of the Commissioner in promulgating rules on credit scoring. With HB 5803 pending before the House Insurance Committee, they assert that the Legislature is the appropriate body to deal with the practice of credit scoring, and the Commissioner should allow the legislative process to proceed. Representative David Robertson (51st District) did not actually state a position on the proposed rules; his remarks imply he thinks the Legislature should handle the issue. Those people speaking for Allstate Insurance, Farm Bureau, Michigan Chamber of Commerce, Michigan Insurance Coalition, National Association of Mutual Insurance Companies, and Progressive Michigan Insurance Company all support HB 5803, join in the legislators' objection, and directly request the Commissioner withdraw the rule set. The Michigan Chamber of Commerce also asserts the Commissioner's action violates Article III, §

2 of the Michigan Constitution on separation of powers. That section prohibits one branch of government from exercising powers properly belonging to another branch.

Agency Response:

a) It is appropriate for the Commissioner to promulgate rules dealing with the practice of insurance credit scoring. Article V, § 8 requires the Governor, as head of the Executive Branch, to "take care that the laws be faithfully executed." MCL 500.202 identifies the Commissioner as the chief officer of the Department of Insurance, and MCL 500.210 directs the Commissioner to promulgate rules to effectuate the purposes and to execute and enforce the insurance laws of this state. Rule Set 2004-022LG is being promulgated under this rule-making authority, and the Commissioner is performing her duty as acknowledged by the Supreme Court in Shavers v Attorney General, 402 Mich 554, 597; 267 NW2d 72 (1978) to "give substantial meaning to statutory standards" in the Insurance Code. The Commissioner by this rule set is clarifying that a "reasonable classification system" required of all automobile, home, and personal lines insurers under Chapters 21, 24, and 26 of the Insurance Code, does not include insurance credit scoring as a rating factor. Her action is consistent with all the provisions of the Code cited in Block #2 of this report, describing the purpose and background for these rules.

This proposed rule set is also needed to clarify the purpose of MCL 500.2111, which provides a clear procedure for an insurer seeking to use a new rating factor for automobile or home insurance not specifically listed in that section. The Commissioner may authorize a new factor only after an Administrative Procedures Act (APA) hearing, at which the insurer must prove that the additional factor "would encourage innovation, would encourage insureds to minimize the risks of loss from hazards insured against, and would be consistent with the purposes of this chapter." MCL 500.2111(9). The Michigan Rules of Evidence apply in an APA contested case hearing. An administrative law judge would have an opportunity to hear and evaluate evidence under legal standards adopted statewide to assure the validity and reliability of expert testimony. The administrative law judge would determine whether the studies done on credit scoring are relevant, material, and admissible under the evidentiary standards for such proof and would determine if the claims of insurers for credit scoring satisfy the statutory requirements for new and additional rating factors quoted above. Under the APA and Insurance Code, the Commissioner would review that decision, and the Commissioner's decision thereafter would be subject to judicial review.

This proposed rule set also effectuates the purposes of the other statutory provisions cited in Block 2 of this Agency Report. HB 5803, the pending legislation that Representative Fulton Sheen called "an outstanding piece of legislation" in his Grand Rapids public hearing testimony, is not intended to carry out these purposes. Rather, HB 5803 would silently and effectively eliminate the entire MCL 500.2111(9) process described above for approval of additional rating factors. Through its inconsistent provisions, HB 5803 also would silently but effectively eliminate important consumer protections contained in the Essential Insurance Act under sections 2110a, 2111, 2112, 2113, 2116, 2117, and 2118 of the Insurance Code.

In place of these protections, HB 5803 allows insurers to create tiers of "eligible persons" using standards unrelated to the specific risk classification factors permitted under the Insurance Code, standards that may be "unfairly discriminatory." The inadequate notice requirements contained in HB 5803 would obstruct consumers from determining if the rate charged for their insurance policy is accurate and fair, a requirement of existing law. HB 5803 does not require insurers to provide the consumer with all of the disclosures required by FCRA, and does not make a failure to do so a violation of the Insurance Code. These practices are totally inconsistent with the purposes of the Insurance Code to assure that essential insurance is available and affordable to all.

Suggestion to Modify:

b) Stephen Calkins, L. Richard Fischer, Auto Club Insurance Association, Farmers Insurance, Insurance Institute of Michigan, Michigan Insurance Coalition, Property and Casualty Insurers Association of America, and State Farm all assert that FCRA, specifically 15 U.S.C. 1681b(a)(3)(C), authorizes the use of credit information "in connection with the underwriting of insurance involving the consumer." They argue that FCRA likely preempts any state law or administrative rule purporting to prohibit the use of consumer report information for underwriting consumer insurance applications.

Agency response:

b) FCRA is a law designed to deal primarily with extensions of credit. It is not an insurance law, and its remedies are not designed to protect insurance consumers. That is the purpose of the Michigan Insurance Code, under which the Commissioner is promulgating Rule Set 2004-022LG.

FCRA regulates primarily consumer reporting agencies and furnishers of information to consumer reporting agencies, not insurers, though FCRA does require insurers to supply adverse action notices to the consumers denied coverage or charged more for coverage because of adverse credit information. Congress clearly stated its intent in 15 U.S.C. 1681t not to preempt state laws except those that are inconsistent and then only to the extent of the inconsistency. Congress (15 U.S.C. 1012, McCarren- Ferguson Act) and the courts (e.g. California v ARC Am. Corp., 490 U.S. 93, 101 (1989)) have repeatedly recognized the "business of insurance" as an area traditionally regulated by the states and thus an area where a party asserting preemption must overcome a presumption in favor of the state law or regulation in question. In addition, the Supreme Court has interpreted the McCarren-Ferguson Act "business of insurance" phrase as targeting the relationship between the insurer and the insured:

> But, whatever the exact scope of the statutory term [business of insurance], it is clear where the focus was – it was on the relationship between the insurance company and the policyholder. Statutes aimed at protecting or regulating this relationship, directly or indirectly, are laws regulating the business of insurance.
> Securities and Exchange Commission v National Securities, Inc., 393 US 453, 460 (1969).

The provisions in Chapters 21, 24, and 26 of the Insurance Code requiring a "reasonable classification system", limiting permissible rating factors, and setting standards for premium discounts are clearly laws regulating the relationship between the insurance company and policyholder and thus laws regulating the business of insurance. The proposed rules clarify and implement the requirements of those laws. For example, MCL 500.2112 requires an insurer's annual notice to policyholders be of "sufficient detail and clarity so that the policyholder can reasonably verify the applicability and accuracy of the rating classifications," and no one has suggested FCRA, with different disclosure requirements for adverse actions, preempts MCL 500.2112. There is no inconsistency between the two since an insurer can comply with both notice and disclosure requirements.

FCRA itself in 15 U.S.C. 1681t(b)(3)(C) now specifically states that the disclosures of adverse action required by 15 U.S.C. 1681g:

> Shall not be construed as limiting, annulling, affecting, or superseding any provision of the laws of any State regulating the use in an insurance activity, or regulating disclosures concerning such use, of a credit-based insurance score of a consumer by any person engaged in the business of insurance.

In short, FCRA grants insurers access to consumer credit reports, subject to many conditions, and specifies the duties of persons using such reports in any insurance transaction "not initiated by the consumer and that consists of a firm offer . . . of insurance"(15 U.S.C. 1681t(b)(1)(D)), also subject to many conditions. The "Relation to State Laws" section of FCRA (15 U.S.C. 1681t) is silent, however, on the duties of persons attempting to use a credit-based insurance score in situations other than those "not initiated by the consumer." OFIS believes that silence is clearly deliberate in light of the language of 15 U.S.C. 1681b(3)(C) quoted above, specifically preserving from preemption any provision of any state law regulating use in an insurance activity. Rule Set 2004-022LG is not inconsistent with FCRA. The rule set simply clarifies that credit-based insurance scores cannot be used under Chapters 21, 24, and 26 of the Insurance Code, i.e. under laws that never authorized the use in the first place. Nothing in FCRA prevents the Commissioner from promulgating a rule to clarify and implement important provisions of the Michigan Insurance Code since insurers can comply with both the federal act and state law. (e.g. Credit Data of Arizona v State of Arizona, 602 F.2d 195 (9th Circ. 1979); Wells v Shelter General Ins. Co., 217 F.Supp.2d 744 (S.D. Miss., 2002)).

Preemption is a complex issue and one that will not be decided by OFIS, the Office of Regulatory Reform, or the Joint Committee on Administrative Rules. OFIS generally agrees with the March 31, 2003 FCRA preemption analysis prepared by D.J. Powers for the Center for Economic Justice, available online at http://www.cej-online.org/credit_scoring_preemption_memo.pdf. This analysis was done before passage of the Fair and Accurate Credit Transactions Act (FACT), amending FCRA, but many of the basic principles have not changed.

This agency response merely outlines the reasons why the Commissioner does not think rule set 2004-022LG is likely to be preempted. Section 215 of FACT requires the Federal Trade

Commission (FTC) in conjunction with other agencies to conduct a study on the extent to which the use of credit scores and credit-based insurance models affect the availability and affordability of credit and insurance, with the report due in December 2005. Section 319 of FACT directs the FTC to conduct an ongoing study of the accuracy and completeness of information contained in credit reports, with an interim report due one year from enactment and biennial reports due thereafter. The Commissioner is reasonably confident no court will interpret FCRA and FACT to require a state to add insurance credit scoring to its exclusive list of rating factors for automobile and home insurance (MCL 500.2111) or to change its standards for allowing premium discounts (MCL 500.2110a) so that the FTC can study the practice and report to Congress a few years down the road how much it has harmed or not harmed Michigan consumers.

The 2003 amendments to FCRA have not been fully implemented, much less judicially tested. Neither FCRA nor FACT addresses the use of insurance credit scoring as a rating factor or as part of a reasonable classification system, the bases in the Michigan Insurance Code for the promulgation of this rule set. A number of states (MD, HI, CA, MA) have banned insurance credit scoring for either home or automobile coverage or both, and there has been no successful legal challenge in those states based on the FCRA preemption argument.

Suggestion to modify:

c) Nearly every opponent to Rule Set 2004-022LG identified in Block 10 of this report – Business and Industry, Academic and Legal, Consumers, and Agent – has asserted, as justification for the use of insurance credit scoring in rating automobile, home, and other personal lines insurance, that there is a correlation between low credit scores and a propensity for loss. The correlation, each opponent claims, has been established beyond doubt by a series of expert studies, with different opponents citing different studies. Some attach the studies they rely upon to their comments, while others simply reference them. About half of the insurers commenting also attached charts reflecting loss ratio propensity in relation to credit scores for their own books of business. Opponents of the rule set arguing correlation all assert that the correlation "proved" by the different studies alone is adequate justification for the use of insurance credit scoring. They describe the practice as a tool that allows an insurer to apportion risk more accurately and thus charge more to those policyholders with low credit scores and thus more likely to file claims, while charging less to those policyholders with higher credit scores and thus less likely to file claims.

Agency response:

c) The Commissioner and OFIS staff are not convinced that the studies relied upon by the industry dispose of the issue of whether or not there is a correlation between credit scores and propensity for loss in the automobile, home, and personal lines market in Michigan. None of the studies have passed Michigan Rules of Evidence muster for objective scientific proof. None have been subjected to an adversarial process including questioning the experts in the course of an APA hearing, as required by MCL 500.2111(9). This synopsis of the public hearings and comments on Rule Set 2004-022LG obviously cannot include a full analysis of each study relied upon by the industry, but it can address the studies cited and explain why the Commissioner remains skeptical of their worth and applicability to a reasonable classification system for automobile, home and other personal lines coverage under Chapters 21, 24, and 26 of the Insurance Code.

(1) Tillinghast-Towers Perrin. 1996. Insurance Bureau Scores vs. Loss Ratio Relativities. Prepared on behalf of Fair Isaac. Tillinghast-Towers Perrin: St. Louis, MO. Fair Isaac made the original proposal for this study to the NAIC Credit Reports Subgroup in 1996, and that group rejected it in 1996 as not providing a meaningful way to examine the correlation of credit histories to risk of loss, primarily because it called for a univariate instead of a multivariate analysis. The NAIC suggested before the study was even performed that its findings may be counterproductive and misleading. Fair Isaac, a vendor of credit scoring models, proceeded with the study anyway, using a database from nine property and casualty companies – three automobile, five home, and one personal property. Tillinghast-Towers Perrin conducted the study as directed by Fair Isaac, and it predictably found a correlation between credit score ranges and loss ratios. Two years later, Wayne Holdredge, the principal analyst for Tillinghast-Towers Perrin in this study wrote for the March 9, 1998 issue of *BestWeek* he could not understand industry reluctance to pursue the additional studies sought by the NAIC because he found the arguments for additional research "compelling."

(2) Commonwealth of Virginia, State Corporation Commission, Bureau of Insurance. 1999. Use of Credit Reports in Underwriting. The Virginia Bureau of Insurance prepared this report at the request of the Virginia General Assembly. All data evaluated is Virginia specific. The Bureau used data compiled from a survey (to which 50% of Virginia automobile insurers and 60% of Virginia home insurers replied) information contained in company filings with the Bureau, and credit variables supplied by Fair Isaac. The study did find a statistical correlation between credit score and policy loss performance and also found that income and race "alone" are not reliable predictors of credit score. The American Academy of Actuaries evaluated this study for the National Association of Insurance Commissioners (NAIC) and concluded in its November 15, 2002 report to the NAIC that it could not comment on the validity of the conclusions reached or the quality of the supporting evidence because the Bureau had not included any supporting data in its report to the Assembly. At the time of study, credit scoring was not widely used in Virginia, and the Bureau expressed concerns in its report about the long-term effect of credit score use on Virginia consumers.

(3) Bureau of Business Research (BBR), McCombs School of Business, The University of Texas at Austin. March 2003. A Statistical Analysis of the Relationship Between Credit History and Insurance Losses. Then Lt. Governor Bill Ratliff requested this study in 2002 on behalf of the Texas Legislature. Five Texas automobile insurers supplied policy information from the first quarter of 1998 that included the following 12 months' premium and loss history.

ChoicePoint supplied the “credit scores” using the methodology it markets to automobile insurers. The study found that poor credit history strongly relates to insurances losses in the automobile insurance industry. This study is Texas specific and has provoked blistering commentary from consumer rights groups such as the Texas-based Center for Economic Justice for misrepresenting its methodology – claiming to provide a multivariate analysis when BBR only used the simple loss ratio method rejected by the NAIC in 1996, when proposed by Fair Isaac for what became the Tillinghast-Towers Perrin study.

(4) EPIC Actuaries, LLC, Michael J. Miller and Richard A Smith. June 2003. The Relationship of Credit-Based Insurance Scores to Private Passenger Automobile Insurance Loss Propensity. Sponsored by the Alliance of American Insurers, the American Insurance Association, the National Association of Independent Insurers, and the National Association of Mutual Insurance Companies. The study is based on a random sample of automobile policy and claim records from all 50 states on policies in effect at any time during a 12-month period ending June 30, 2001, with claim counts, paid claim amounts, and reserves on known outstanding claims reported as of June 30, 2002. ChoicePoint provided EPIC its ChoicePoint Attract™ score. The study found a correlation between insurance scores and propensity for loss, “primarily due to correlation between insurance scores and claim frequency, rather than a correlation between insurance scores and average claim severities.” (p 1) The study also found that “an analysis of property damage (PD Liability) claim frequencies by insurance score groups for each of the fifty states indicates that the study results apply generally to all states and regions,”(p 4) with graphs for each state supplied in Appendix Q. The Appendix Q graph including Michigan (p 8) together with the Appendix Q summary chart (p 18) captioned, “Claim Frequency by Insurance Score by State,” together marked Attachment 5, are incorporated into this report. Anyone examining these documents can see instantly, both from the pattern of the graph lines and from the summary chart, on which the lowest credit score is 607 and the highest 997, that the Michigan data simply do not support the study’s conclusions. Claim frequency is exactly the same for people with credit scores of 607, 659, and 837. Claim frequency is exactly the same for no hit/thin files and scores of 693, 774, and 802. In fact, Michigan automobile policyholders with the lowest claim frequency in EPIC data are those with credit scores of 722 and 748, i.e. people in the middle of the pack.

There are other studies purporting to show a correlation between loss frequency or propensity for loss or loss ratios and insurance credit scores, but the opponents to this rule set have not offered them as justification for the correlation, and none of the other studies are based on data specific to Michigan as far as OFIS knows. Most of these studies focus on automobile insurance. James E. Monaghan, 2000, The Impact of Personal Credit History on Loss Performance in Personal Lines, based on data for new automobile policies written by one insurance company in 1993 and earned premium and loss information for these policies from 1993 through 1995, and Conning and Company, 2001, Insurance Scoring in Personal

Automobile Insurance – Breaking the Silence, based on secondary research and essentially an evaluation of the conclusions reached by other studies, are the two most frequently cited. Neither seems to include any Michigan data. In addition, the agency is not aware of any study at all, independent or sponsored by the insurance-industry, that includes data on Michigan home policies.

It is difficult to analyze the charts included by some insurance companies in their written comments on these rules because some deal with frequency of claims, others with costs of claims; and the companies do not always define clearly what they are comparing. In any event, none of the above studies and none of the charts on a particular insurer's book of business have been scrutinized for admissibility of testimony by experts under Rule 702 of the Michigan Rules of Evidence in either an APA contested case or a Michigan trial court.

The opponents to this rule set have argued that there are no studies refuting the correlation established by the above studies. Given the limitations of the studies described above – univariate analysis, the use of automobile data only from states other than Michigan, and the total lack of correlation clearly evident in the only study including data on Michigan automobile policies, a fact the authors of the EPIC study also fail to mention in their commentary – it is hardly surprising that the Commissioner and OFIS staff question the validity of the argument offered by the industry that "study after study" has found a correlation between insurance credit scores and propensity for loss. The agency believes the only conclusion that can be drawn from these studies is that there may be a correlation. The correlation between insurance credit scores and propensity for loss may well be to insurance rating what cold fusion was to physics or hormone replacement therapy was to medicine: a theory that seemed promising but crumbled when subjected to additional scrutiny.

Even if the Agency accepted the industry's correlation argument, however, that would not make insurance credit scoring a factor permitted in rating essential insurance under MCL 500.2111; and insurance credit scoring does not qualify as a premium discount under MCL 500.2110a because it is not uniformly applied and, by industry admission, does not reflect "reasonably anticipated reductions in losses and expenses."

The uniform application requirement of MCL 500.2110a cannot be met by the use of insurance credit scores simply because the information contained in credit histories is often inaccurate. Even though a consumer may have the opportunity to correct any error in their personal report, it requires the insured to refute a negative report that may be reasonably in dispute. This argument becomes even more important when no credit history can be found for an individual or at the very least a thin file is found. The insurer has no logical way to assess the amount of discount deserved by these individuals; which discount must be uniformly applied to all its insureds across the state. The unreliability of the data that is the basis of this classification system would also cause insurance credit scoring to violate rating criteria contained in Chapters 24 and 26 of the Insurance Code as well.

Insurance agents provided testimony at the hearings that their customers cannot get the credit reporting agencies, the model vendors such as Fair Isaac and ChoicePoint, or the insurers to explain premiums charged based on credit scoring. The three entities shuffle people back and forth, with the agent – as the consumer's contact with the insurer - hearing about the consumer's frustration. The consumer reporting agencies (Equifax, Experion, or TransUnion) only sell reports; they don't set premiums. The insurance scoring model vendors (ChoicePoint, Fair Isaac) only sell scoring models; they don't set premiums. The insurers only use these "objective" models to rate people; they don't develop them. The consumer finds him or herself placed in a category and patted on the back with a "discount" or chastised with "no discount" and some sort of admonition regarding his or her "financial responsibility" and then told to go somewhere else to figure out why. Hundreds of people offered oral and written comments to OFIS objecting to the use of their private financial information for a purpose they never authorized.

An insurance credit scoring discount cannot be uniformly applied by an insurer not only because of the inherent inaccuracies in credit reports, but also because a good credit history does not equal a good credit score or favorable insurance treatment. Credit scoring is a very arbitrary process. A score can vary from "high risk" to "low risk" depending upon which credit reporting agency an insurer uses. A credit score can change drastically in a very short period of time for no apparent reason. Such unreliability precludes uniform application.

Birny Birnbaum of the Center for Economic Justice, who spoke at all four public hearings, has argued persuasively that insurance credit scores are not measures at all of financial responsibility, as claimed by the industry. Mr. Birnbaum notes that a good credit score does not equal a good credit history or favorable insurance treatment, because most models are based on factors such as:

- the type of credit, with consumer finance loans less favorable than bank loans, even if the consumer makes each payment on time;
- the number of credit cards, regardless of how often they are used;
- the type of cards, with oil company credit cards favored over cards from tire stores, parts stores, or automobile dealers;
- the length of time credit has been established, with different models using different magic numbers for the number of months deemed good;
- the length of time since opening the last account,
- the number of consumer-initiated credit inquiries.

The underlying factors vary from company to company, from one insurance scoring model to another, from one model for automobile to another model for home. A "financial responsibility" score for an automobile policyholder may be "good" while the "financial responsibility" score for the same person as a home policyholder may be different and worse (or better) within the same company. This is a system rife with segmentation and with assumption stacked on assumption.

As previously mentioned, the industry itself has admitted that the use of insurance credit scoring does not reflect "reasonably anticipated reductions in losses and expenses." We again incorporate the statements of two individuals who represent the industry in opposition to this rule set in which they admit that the use of insurance credit scoring does not result in a reduction in losses. Bill Martin, Chief Product Management Expert for the State of Michigan for Farmer's Insurance Group, testified in front of the Senate Banking and Financial Institutions committee on June 24, 2004 in room 100 of the Farnum Building, as follows:

> Because a ban on credit scoring really doesn't do anything to insurance costs, it only changes the way we rate for those costs. We would end up charging everybody in this state an average rate, an average across all scores, with a ban. And that of course would mean that people with better than average insurance scores would see their rates go up and people with worse than average insurance scores would see their rates go down.

Additionally, Amy Shalley of State Farm Insurance Companies testified at the July 28, 2004 Flint Public Hearing on this rule set as follows:

> Insurance use of credit in pricing has been and will continue to be revenue neutral. Insurance scoring does not change the total amount of premium collected by the insurance companies and a ban of its use will not change the total amount either. What the use of insurance scoring does change is the amount of premium paid by each individual consumer.

Fortunately, Michigan consumers also have protection against this type of rating classification system in Michigan law. The Commissioner must enforce the Insurance Code as written and cannot elect to ignore exclusive rating factors and clear standards for use of premium discounts in essential insurance on the basis of mere speculation as to accuracy, correlation, and "financial responsibility."

Suggestion to Modify:

d) Fair Isaac, ChoicePoint, TransUnion, and the Consumer Data Industry Association –all vendors of consumer credit report information – assert that credit reports, while not perfect, are generally accurate; and nearly all representatives of business and the insurance industry submitting comments in opposition to the Rule Set 2004-022LG, accept the assertion of accuracy and then expand it to argue that credit reports and the resulting insurance credit scores are an objective and accurate measure of "financial responsibility." These claims of accuracy for credit reports tie in with the correlation argument of Section 11(c) of this report and the preemption argument of Section 11(b), since the collection of consumer credit information is generally governed by FCRA. Together these arguments are the industry justification for insurance credit scores as a legitimate business practice insurers use in rating risks and, they assert, should be able to continue to use, without interference from the Commissioner and Rule Set 2004-022LG.

Agency Response:

d) In this aspect of the dispute over insurance credit scoring, the numbers the industry presents and the numbers the consumers or public interest groups present are widely divergent.

TransUnion states that the credit reporting industry, as a whole, currently makes two billion updates each month to more than 200 million credit files, with very few errors. TransUnion, citing Allstate 2002 data, states only 3,000 Allstate customers submitted written requests disputing information in the more than 17 million credit reports Allstate ordered. Since only a small number of the disputes were "legitimate," and a smaller number actually affected the person's "insurance score," and yet a smaller number actually changed the discount category to which the customers had been assigned, Allstate concluded, "The number of inaccurate credit reports that affect the premium charged is at most a subset of a subset of a subset of .017 percent."

At the other end of the spectrum, the Consumer Federation of America, U.S. Public Interest Research Group, and Consumers Union have all conducted studies, the first two on very small samples, finding overall error rates as high as 79% and serious error rates as high as 25%, with a serious error defined as one that could result in a denial of credit. Of course, a 25% serious error rate on 200 million credit files would convert to 50 million files containing serious errors.

Because of this wide divergence in opinion, it is important to consult independent sources such as the Federal Reserve and the United States General Accounting Office (GAO). A February 2003 Federal Reserve Bulletin (Robert Avery, Paul Calem, Glenn Canner, and Raphael Bostic, "An Overview of Consumer Data and Credit Reporting") found that credit reports contained many inconsistencies, including a missing credit limit on one or more revolving accounts for approximately 70% of the consumers in the study's sample, accounts with positive balances not up to date for approximately 8% of all accounts, and between 1% of 2% of the files supplied by creditors reporting only negative information, among other things.

Representatives of the three major consumer reporting agencies and the Consumer Data Industry Association told the GAO in 2003 that they do not maintain data on the frequency of errors in credit reports. The GAO issued a report on July 31, 2003, titled, "Limited Information Exists on Extent of Credit Report Errors and Their Implications on Consumers" (GAO-03-1036T) that also cites information from the Federal Trade Commission (FTC), reporting an increase in FCRA consumer complaints received annually from 1997 through 2002, from 1,300 per year to nearly 12,000 per year. Just a little over a year ago, the GAO concluded that, "The lack of comprehensive information regarding the accuracy of consumer credit reports inhibits any meaningful discussion of what more could or should be done to improve credit report accuracy." (p 17) The GAO recommended further study by the FTC; and Congress, as noted earlier, has ordered the FTC to study both credit report accuracy and completeness, with the first report due by the end of December 2005. (FACT, § 319)

The Commissioner is persuaded that the concerns of the GAO, the FTC and the Federal Reserve about inaccuracies in credit reports reinforce the purpose of this rule set in enforcing the uniform discount application provisions in MCL 500.2110a.

Suggestion to Modify:

e) Many insurers have alleged that implementation of the rule set will force "good" risks to subsidize “bad risks” and result in premium increases for most Michigan policyholders: Auto Club Insurance Association – 66%, Farm Bureau – 55% of automobile, Farmers – 59% of home and over 50% of automobile, Frankenmuth Mutual – over 90% in Genesee County, Fremont Mutual – 66%, Hastings Mutual – 77.6% automobile and 84% home. Progressive and State Farm allege that the “base rate adjustment” required by the rules is not “actuarially sound” and should not be based on a “weighted average.” State Farm also alleges that a reduction in base rates is tantamount to a “taking” and arguably unconstitutional.

Agency Response:

e) The industry has submitted to OFIS no real evidence to support their claim that if they cannot classify insureds based on credit scores in Michigan, good risks will be forced to subsidize bad risks. Most of the studies purporting to show a correlation between insurance scores and a propensity for loss apply primarily to automobile coverage only, not home or other personal lines, and were funded by the insurance industry using methodology rejected by NAIC. Appendix Q to the EPIC Actuaries study of automobile claims in fact shows little variation in frequency of claims by insurance score in Michigan, with the lowest frequency arising not from those people with the best credit insurance scores now receiving the highest discounts but from those with fair-to-middle scores and now receiving small or no credit scoring discounts.

OFIS has received no independent study of any variety applicable to Michigan home or other personal lines policyholders, or applicable to the weight given underlying factors in any insurance scoring model. There is not one, perfect set of rating classification characteristics. There are many ways to group consumers for purposes of developing individual premiums that meet standards of actuarial soundness and all involve some degree of subsidy. The whole point of insurance is to spread the risk of loss across all policyholders. The Michigan Legislature, in MCL 500.2111, set forth the rating classification factors that are reasonable for use in automobile and home insurance. These are the factors that the Legislature has told insurers to use to evaluate the relative “goodness” or “badness” of their customers’ risk profiles.

In response to the claims that most policyholders will see a rate increase upon implementation of these rules, OFIS has examined the data of several major insurers and found that in some there will be more decreases than increases and in others, the reverse. Overall, as noted elsewhere in this report, the premiums collected will remain the same; it is just that they are distributed differently among policyholders. This effect has been described as a “zero sum game” and is recognized by companies and consumer advocates alike.

However, to achieve the reduction in base rates in a less complex manner and one independent of territorial adjustments, OFIS amends the manner of calculating the base rate adjustment according to a suggestion from the Center for Economic Justice. The Agency amends Rule 1, proposed Rule 500.2151, by deleting the subsection (3) definition of “base rate adjustment” and amends Rule 4, proposed Rule 500.2154, as follows:

Rule 4. (1) For new and renewal policies effective on or after July 1, 2005, an insurer shall

adjust base rates in the following manner:
(a) Calculate the sum of earned premium at current rate level for the period January 1, 2004 through December 31, 2004.
(b) Calculate the sum of earned premium at current rate level with all insurance score discounts eliminated for the period January 1, 2004 through December 31, 2004.
(c) Reduce base rates by the factor created from the difference of the number 1 and the ratio of the amount of subdivision (a) to the amount of subdivision (b).
(2) The insurer shall file with the commissioner a certification that it has made the base rate adjustment and documentation describing the calculation of the base rates adjustment. The insurer shall file the certificate and documentation not later than May 1, 2005.

As to the "takings" argument, nothing is being taken. All adjustments are prospective. No policyholder will be charged a higher premium for a past rating period. No insurer is required to refund premiums to policyholders for a past rating period. The rules will, instead, require insurers in the future to eliminate the use of insurance credit scoring, a practice that does not conform to current statutory rate factor standards.

Suggestion to Modify:

f) Consumer Bob Mauser of Shelby Township spoke in Detroit and also submitted written comments suggesting that the proposed rule to ban credit scoring would not have its intended effect if Michigan did not also ban comparative rating by the credit bureaus. Consumer Lynn Gustafson of Lansing wrote to suggest that the proposed rules to ban credit scoring are not broad enough to ban other ways that insurance companies might find to use her credit history and records. These two consumers specifically framed the issue, but dozens of others wrote to protest the use of their "credit information" or "personal information" in charging for insurance. These consumers who generally support the credit scoring ban suggest that the definition of "insurance score" in Rule 1(1) as "a number or rating" would not prevent an insurer from submitting its policyholders names with identifying information to a vendor selling insurance scoring models and then getting them back some list organized on the basis of credit information but without the use of a number or score.

Agency response:

f) Minor changes in the wording of this definition will clarify that the term "insurance score" is appropriately broad. The Agency amends Rule 1(1), proposed Rule 500.2151, as follows:

(1) "Insurance score" means a number, ~~or~~ rating, ~~that is derived from an algorithm, computer application, model, or other process~~ OR GROUPING OF RISKS that is based in whole or in part on credit information for the purposes of predicting the future loss exposure of an individual applicant or insured.

Suggestion to Modify:

g) Allstate, Farm Bureau, and Progressive all object to and seek clarification of the meaning of the January 1, 2005 effective date. Allstate says it needs 315 days to retool for renewal policies and 250 days for new policies. Farm Bureau argues that the rule as written has problems since companies typically contract for 6 or 12-month periods. If required to change rates mid-term, some policyholders would be required to pay additional premium, and Farm Bureau and its insureds would have to deal also with lienholders on insured property. Farm Bureau suggests changing the effective date language to "policies effective on or after" a certain date. Progressive argues that applying the new rule to policies in force on a particular date impairs the obligation of contract, and it and most other companies need 30-60 days lead-time on processing renewals.

Agency Response:

g) The Agency acknowledges that the rule promulgation process is taking longer than expected. Holding four public hearings took additional time, and the Agency had to review nearly a thousand comments received, many of them lengthy, and many referencing lengthy studies. Since insurance credit scoring is an important issue, OFIS took the time for a thorough review and preparation of a thorough report. The Agency agrees that insurers do need lead time to perform the base rate adjustment required to implement these rules and that January 1, 2005 is no longer a realistic compliance date. The Agency amends Rule 3(1), proposed Rule 500.2153, as follows:

Rule 3. (1) ~~On and after January 1, 2005,~~ FOR NEW AND RENEWAL POLICIES EFFECTIVE ON AND AFTER JULY 1, 2005, an insurer in the conduct of its business or activities shall not use an insurance score as a rating factor.
(2) ~~On and after January 1, 2005,~~ FOR NEW AND RENEWAL POLICIES EFFECTIVE ON AND AFTER JULY 1, 2005, an insurer in the conduct of its business or activities shall not use an insurance score as a basis to refuse to insure, refuse to continue to insure, or limit coverage available.

Suggestion to Modify:

h) Birny Birnbaum of the Center for Economic Justice has suggested the addition of a new Rule 6 to require companies to notify consumers of the elimination of insurance credit scoring, as follows:

R 500.2156 Notice to policyholders
Rule 6: For new personal lines policies issued between January 1, 2005 and December 31, 2005 and for the first personal lines renewal policies only issued on or after January 1, 2005, an insurer shall include the following notice with the declaration page for new policies and with the first policy renewal notice. The following notice shall be on a separate sheet of paper no smaller than three inches by eight inches and in type size of at least 12 point.

The Commissioner of Insurance has determined that the use of credit-based insurance scores for setting automobile and home rates is not permitted under the

Michigan Essential Insurance Act. Accordingly, the Commissioner has ordered all insurers to stop using insurance scores for rating for policies effective on or after January 1, 2005. The Commissioner has NOT ordered or required any insurer to raise premiums for any consumers. The Commissioner encourages you to shop around if you feel your insurance premiums are too high.

Agency Response:

h) Since insurers are already required under the Essential Insurance Act to provide annual notice to policyholder giving specific detail about the rates being charged, the Agency does not see a need for any additional notice. Policyholders also have rights to specific rate information under Chapters 24 and 26 of the Insurance Code. OFIS will closely monitor the information shared by insurers with policyholders and take appropriate action against those who violate the Insurance Code.

Name of person completing this report: **Dorothy Cherry (P26413)** (Print)

Date of report: October 1, 2004

Attachment 3 Business and Industry Opposition Arguments by Company or Association

Attachment 5 Appendix Q EPIC Actuaries